



## **Explanation of the Procedure for Fraud and Financial Incapacity**

### **1. Introduction**

The Procedure for Fraud and Financial Incapacity aims to provide insight in and control over the risks of fraud and financial incapacity. This is necessary for the organisation to remain in control and also because some of our back-donors require that there should be a clear procedure to prevent and handle the cases where fraud and financial incapacity is suspected or detected.

A procedure is necessary in order to make the process of submitting, investigating, taking action and closing cases more efficient and more accessible for the end-users (RMs, HoDs, POs and FOs). Also reporting on the submitted cases will be improved.

With this procedure the Audit Unit (further AU) aims:

- To increase awareness amongst the involved employees of the risks and consequences of fraud and financial incapacity;
- To have better insight in the risks ICCO & Kerk in Actie are incurring;
- To prevent future mistakes by keeping better records of the history;
- To facilitate that the employees share experiences on this area and learn from each other.

### **2. What is fraud and financial incapacity?**

Fraud and financial incapacity have many definitions. For ICCO & Kerk in Actie they are defined as follows:

- **Fraud:** is the intentional misuse of funds by the partner organisation or one of its employees. "Fraud can involve one or all of the following:
  - Misrepresentation of facts
  - Breach of the responsibilities of the contract
  - Suppression of truth
  - Omission of critical facts." (Zack, G.M., 2003)
- **Financial Incapacity:** is the lack of internal resources (personnel, capacity, funds, systems, equipment, etc.) to manage and administrate funds properly and/or to make the required reports.

Both financial incapacity and fraud can result in funds not being spent in accordance with the contract with ICCO & Kerk in Actie. An important difference between financial incapacity and fraud is that the first is not deliberate while the latter is.



### 3. How to detect Fraud or Financial Incapacity

For POs and FOs it is often difficult to identify fraud and/or financial incapacity, because the monitoring of the partner's performance is based on the information that the partner is willing to share in reports and during visits. Therefore the signs or symptoms of fraud and financial incapacity are often indirect and intuitive. However in this section a few possible signs are enumerated. When a combination of some of these signs is observed, the PO and FO should stay alert and should inform the RM/HoD.

Signs that can be observed at distance:

- Narrative, financial or auditors reports to ICCO & Kerk in Actie have delays of more than 3 months.
- The external auditor of the partner expressed a qualified opinion on the institutional or project financial statements.
- An anonymous letter or notification is received from (former) employees, beneficiaries or other external parties.
- An external evaluation appoints that the results that were agreed upon in the contract were not achieved due to organizational problems.
- There is a lack in transparency in the financial reports received from the partner regarding:
  - How core costs (overhead) are distributed over the several projects;
  - What is registered under each budget line;
  - How the organisation deals with exchange gains or losses and interest gains or losses.
- The partner refuses to cooperate with external evaluations and/or audits.
- Other donors are withdrawing their funds or phasing out.
- The partner is listed on a blacklist of other donors (e.g. List of Debarred Firms of the World Bank) or the PO or FO hears rumours from colleague organisations.
- Budget monitoring reports showing inconsistent behaviour between line items. E.g. project related expenditure is underspent due to delays in the implementation but fuel is overspent.

Signs that can be observed in the financial records of the partner:

- Lots of corrections to the manual cashbook, including extensive use of white-out fluid.
- Manual records that look as if they have been written on the same day, same hand, same pen. Could be an evidence of rewritten or duplicate books.
- Delayed banking of cash received, shown up by bank reconciliation.
- Records not being kept up to date so managers cannot detect acts of false accounting.
- Missing supporting documents (from: Mango, 2007)

Non-financial signs that can be observed during a visit:

- One employee working very long hours – first in and last out.
- Never taking holidays – to prevent anyone else seeing their records.



- Change of lifestyle – spending patterns don't match with income.
- Smoke screens: making false accusations of other colleagues to win time.  
(from: Mango, 2007)

#### **4. How to apply the procedure**

In short, the procedure is as follows:

1. **A new case is submitted:** The PO and/or FO observe signs of fraud or financial incapacity at the partner and decide to report a new case to the RM/HoD. The case is reported to AU (in MSD) and the RM/HoD will raise the risk level to 4.

2. **Investigation:** The PO and/or FO start an investigation to find out what is the underlying reason for the observed signs: is it fraud or is it financial incapacity?

The partner is informed of the fact that it is under investigation and that payments are deferred in the meantime. Some tools that can help in the investigation process are:

- Correspondence with the partner to ask for clarification;
- Information from other donors;
- Visit of PO and/or FO to the partner;
- Financial audit or RMA by an external auditor chosen by ICCO. Costs and benefits should be balanced. Costs are to be covered by program budget;
- AU can also be asked to give advice on how to investigate or how to correspond with the partner.

Results of the investigation phase can be:

- Financial Incapacity is confirmed;
- The case remains uncertain;
- Fraud is confirmed.

3. **Action Plan:** In some cases the PO/FO and RM/HoD can decide that the relation with the partner should be continued, despite the fact that financial incapacity is confirmed, that the case remains uncertain or that fraud is confirmed (for proven fraud cases continuation is only allowed when funds are returned). Then an Action Plan should be written by the partner in which an improvement trajectory is outlined to address the problems found during the investigation. The PO approves the Action Plan. The partner is informed whether the Action Plan was approved. The PO and FO are responsible for monitoring the implementation of the Action Plan.

4. **End of procedure:** The Procedure for Fraud and Financial Incapacity ends in one of the following ways:

- The relation with the partner is ended. A final feedback letter is sent to the partner. The partner will be marked as a high risk partner to avoid unwanted contracting in the future. (**Optional:** The PO writes a letter before the final feedback letter in which a last chance is given to the partner to comply with the contract conditions; the Letter of Action Plan format can be used and adapted to the specific situation).



- The level of risk of fraud and financial incapacity is considered medium or low again, due to an implemented Action Plan (at least 6 months) and returned funds in case of fraud.

## 5. How is the procedure formalised?

Formalisation of the procedure for Fraud and Financial Incapacity is done in MSD.

A special **Risk Level tab** is available for each partner in the **CRM Module**. All information regarding the procedure can be written in this tab.

The tab has two components:

- **General Observation:** In this field a summary of the case is given by the PO at the moment of submission of a new case. Also regular updates can be given in this field by adding a brief summary of the status.
- **Partner Risk Level Logbook:** With Ctrl N a new field can be created in the logbook. This field will be used by the RM/HoD and AU to change the risk level of the partner. Also the PO, FO, RM/HoD should give quarterly updates of the situation with the partner for risk level 4 partners. Initials and date will appear automatically when a new line is opened in the logbook. The comments cannot be erased after being inserted.

**Risk Levels:** There are four levels of risk for partners that can be chosen:

1 – Small to no risk: All partners start on this level of risk and remain there until the risk level is changed.

2 – Medium risk: This is the level for partners where financial incapacity was observed, where fraud is confirmed but funds were returned to ICCO or to the beneficiaries, and where reports were delayed but in the meantime received. These are partners where the risk is lower but it is good to keep an eye on the partner.

3 – Medium to high risk: This is the level for partners that have delays in reporting of more than 3 months. Every time when a report is due more than 3 months, AU will automatically raise the risk level to 3 as part of the quarterly update process. Also automatically a posting is made in the logbook of the partner. The related PO receives an email reminding the raised risk level with a copy to the RM/HoD (*in actual procedure this is still an option – red. AU*). When the report is received and the receipt dates are filled, MSD will automatically lower the risk level back to 2. The logbook again will be automatically updated.

A confirmation email to PO and RM/HoD will automatically be generated.

4 – High risk: On this level it is under investigation whether the partner is financially incapable or whether it has committed fraud. During the investigation phase the partner stays on this level. If fraud is confirmed but funds are not returned to ICCO & Kerk in Actie or the beneficiaries the partner stays on this level permanently. This is also the level where PO, FO and/or RM/HoD have to register quarterly updates in the CRM module. Every quarter the AU shares the QC2 list with the RM/HoD and requests for this update in MSD. In case the risk level should be lowered, the RM/HoD will send a motivated request by mail to the AU, and also update the logbook with this request.



#### **Consequences for payments:**

Whenever the risk level is higher or equal to 3 all payments (from all projects) to this partner are automatically deferred (frozen). A deferred payment means that the FO can prepare it but the RM/HoD will not be allowed to approve it. When the RM/HoD tries to approve it, a pop-up in MSD will inform him/her that the payment is deferred due to a high risk of fraud or financial incapacity. If in very special circumstances a payment has to be done, AU should be contacted to release payments for a few hours and freeze them again afterwards (by changing the risk levels). When the relation with the partner is ended, the payments will be cancelled by F&A, following the regular procedure at the end of a project.

#### **Authorizations to make mutations:**

The RM/HoD can change the risk level of partners upwards (from 1 to 4) and AU can change the risk level up and downwards (from 1 to 4 and from 4 to 1). The latter is related to the payments (see above). Next to the automatic changes in risk level, only AU can release the payments manually to the partner again, by changing the risk level from 3 or 4 to 1 or 2. The FO, PO, RM/HoD and AU all have authorization to update the logbook and to write in the general observation field.

#### **Preventive function:**

When a relation with a partner is ended due to (possible) financial incapacity or fraud the IT department will be asked to freeze the information and the risk level on Tab Risk Level. Whenever a PO or FO starts a new project for these partners and chooses a partner from the existing CRM list, he/she will see an orange (for level 3) or a red (for level 4) circle in front of the partner's name (see screenshot). This is to prevent future contracting with these partners. Also in the long term it is important that when an employee leaves the organisation and a new employee takes over, the history of the procedure is kept in MSD.

#### **Templates for Correspondence with Partners**

Three templates were developed to communicate with the partner about the procedure:

1. Letter of Investigation: informs the partner that an investigation on possible fraud or financial incapacity is being conducted and explains the procedure.
2. Letter of Action Plan: approves the Action Plan from the partner and sets conditions for continuation of the relation.
3. Letter of End of Procedure: informs the partner that the procedure is ended with satisfactory results and that the relation continues.

These letters can be found in MSD: Documents: New: Document group: Quality & Control.



Summary:

Risklevel	Payments	CRM Color
1 – Small to no risk	Normal	
2 – Medium risk	Normal	
3 – Medium to high risk	Deferred	
4 – High risk	Deferred/ Cancelled	

## 6. Reporting on the procedure

Every quarter AU will extract a QC1 and QC2 report from MSD with the mutations on risk level 3 and 4. From this report AU will be able to see the new cases (changes upwards in level) and also the updates in the logbook. The reports will be shared with the RM/HoD for their input and follow-up.

Every quarter AU is meeting with the Executive Board regarding this procedure. The Risk Level 3 and 4 partners are discussed. This report can also be used for reporting to back-donors whenever required.

## 7. Closure of projects with missing reports

Lack of reports can be a sign of financial incapacity or fraud and should therefore be monitored closely. To monitor the receipt of reports MSD will automatically monitor partners with projects where one or more reports have delays of more than 3 months. The partners automatically receive risk level 3 – Medium to High Risk. This also means that payments are automatically deferred.

Sometimes when reports are not received from a partner for a very long time the PO and RM/HoD want to close the projects, without receipt of all external reports. These cases should be treated carefully because when a PO ends a relation with a partner and therefore closes underlying projects, the chance of receiving reports that account for the expenses is nil. Therefore the amount that is left without reports is considered as unaccounted expense.

Criteria for ending a relation (and thus a project) without receipt of reports are:

- A minimum of three reminders for each project with set deadlines should have been sent to the partner without proper response.



- The amount (or an attempt to it) of unaccounted expenses should be mentioned in the Final Feedback Letter.
- The Final Feedback Letter should mention why the reports could not be produced by the partner (if known).

The RM/HoD should raise the risk level of the partner to 4, write a draft **final feedback letter** and fill in the template **Request for Closure of project with Risk Level 4** (see annex 1). RM/HoD should explain in the letter and the template why the reports were not received, why the project should be closed, summarize the actions taken, and a description of actions taken before or after closure such as termination of the relationship. RM/HoD sends the letter and the signed template to the Audit Unit who will discuss the request with EB and ask for their approval. Once the EB has signed the template the Audit Unit will share the signed template with RM/HoD. RM/HoD attaches the template in MSD, both under the projects and in the CRM module. The Audit Unit will also inform ICT by sharing the letter and signed template by mail that authorization for closure has been given by EB. ICT will change the status of the project to End Report Approved in MSD and file the mail in Top Desk. RM/HoD can then finalize the final feedback letter by signing it and sending the signed final feedback letter to the partner to inform them about the project closure and the termination of the relationship. The partner will remain on risk level 4. Changing the status of the project to Ended follows the normal procedure. If F&A encounters problems in ending risk level 4 projects they first contact the Audit Unit.

It is not allowed to end one project due to lack of reporting and continue the relation with the partner in a new project, unless the partner is unable to report on the first project due to a calamity (fire, flood, theft). In the latter case the Audit Unit should be consulted on how to end this particular project.

### **8. Closure risk level 4 partners**

The EB will decide which relationships with the reported risk level 4 partners will have to be terminated. Based on this input the Audit Unit will ask the RM/HoD to prepare the template (annex 1). Approval as written above. Signed template will be attached in MSD by RM/HoD. A final feedback letter will be written, signed and sent to the partner in which the termination of the relationship is confirmed. ICT will put the project(s) on End Report Approved. F&A will change the status to Ended.

### **9. Considering taking legal steps**

When fraud is confirmed by an independent report and the amount concerned can be clearly defined and proven, the RM/HoD should consider taking legal steps to recover the lost funds. This is foreseen in ICCO's general contract terms and conditions (Article 20).

For Dutch partners it is mandatory to report cases of proven fraud to the police. For the RO's each RM should define whether given the local legal system and culture it is feasible and



wise to report the case to the police. The RM should balance whether the costs of a legal procedure weigh against the benefits of receiving the funds back.

Some pro's and con's are:

Pro's: - Taking legal steps against one partner can have a preventive impact on other partners in a region;  
- ICCO & Kerk in Actie shows that it is a serious donor which takes the responsibilities of partners as binding. This also is positive from the point of view of back-donors.  
- The funds can be recovered.

Con's: - A legal procedure can result in damage to ICCO & Kerk in Actie's image;  
- A legal procedure in a country where democracy is less developed can result in very serious consequences for a partner's employees.  
- The chance of receiving the lost funds back is often very small since the money is gone and the period between the fraud and the legal procedure is long.  
- The costs of a legal procedure are high and the procedure can take very long.

The legal steps can also be taken after a partner relation is ended. The RM/HoD should register in the logbook all steps taken on legal issues. RM/HoD should discuss the possible legal steps and actions with the Legal Officer and with AU in order to make a plan of legal action.

In any case the contract with the partner is subject to Dutch law and disputes will be submitted to the District Court in Utrecht.

**Annex 1:**

**REQUEST FOR CLOSURE OF PROJECT WITH RISK LEVEL 4**

<b>Partner name and number:</b>				
<b>Project name and number:</b>				
<b>Project period:</b>				
<b>Contracted amount (€):</b>				
<b>Paid amount (€):</b>				
<b>Amount covered by audits (€)</b>				
<b>PO:</b>		<b>FO:</b>		<b>RM/HoD:</b>

Summary of reasons why partner received risk level 4 and why closure is necessary:

Summary of actions taken by ICCO & Kerk in Actie to achieve results and account for funds:

- If closure without receipt of all reports, describe whether the criteria for closure in these cases were met:
- A minimum of three reminders for each project should have been sent to the partner without proper response.
  - The amount of unaccounted payments should be mentioned here and also in the Letter of Closure (i.a.).

Steps to be taken before or after closure i.a. (legal action, payment, letter, risk level, other donors)

Approval of closure by RM/HoD (name, function, signature)	Date
Approval of closure by Executive Board (name, function, signature)	Date